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ZNR UUUUU ZZH
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FM AMEMBASSY PRETORIA
TO RUEHC/SECSTATE WASHDC 2541
INFO RUCNSAD/SOUTHERN AFRICAN DEVELOPMENT COMMUNITY
RUCPCIM/CIMS NTDB WASHDC
RUCPDC/DEPT OF COMMERCE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC

UNCLAS SECTION 01 OF 04 PRETORIA 001316

SIPDIS

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DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND
TREASURY FOR OAISA/RALYEA/CUSHMAN
USTR FOR COLEMAN

E.O. 12958: N/A

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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER MARCH 31 2006
ISSUE

¶1. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- February Inflation up 4.5%;
- February Producer Price Inflation Unchanged;
- 4th Quarter Growth Slows; Consumer Demand Still High;
- Skills Initiative Launched;
- Non-Agricultural Employment Grows 1.3%;
- Social Security Agency Begins Operations; and
- SA Slips in ICT Rankings.

End Summary.

February Inflation up 4.5%

¶2. Slightly lower than expectations, February targeted inflation (consumer prices excluding mortgage costs, CPIX) increased 4.5%, well within the South African Reserve Bank's range of 3-6%. Reuters' poll of economists expected February's CPIX inflation to be 4.7%. Overall consumer price inflation reached 3.9% in February. February CPIX inflation was higher than January's 4.3% because of higher food and fuel costs, although the rate of increase in food prices weakened in February. For both December and January, food price inflation contributed 0.3 percentage points, while February food prices contributed only 0.1 percentage points to CPIX monthly inflation. The prices of clothing, footwear and communication equipment showed monthly declines as these industries are impacted by a strong rand, competition from low-cost producing countries, and technological advances. By expenditure group, the lowest quintile experienced the highest inflation in February at 4.4%, while the very high expenditure group saw a 4% inflation rate in the goods they purchase. Source: Statistics SA Release P0141.1, Reuters, Standard Bank, CPI Alert and Investec CPIX Update, March 29.

February Producer Price Inflation Unchanged

¶3. February's producer price inflation increased by 5.5%, unchanged from January 2006's annual change. Food, transport and electrical machinery prices were higher in February, while basic metals, electricity and non-electrical machinery prices came in lower than January's

rate of increase leading to an overall unchanged inflation rate. The producer prices for locally produced goods increased by 5.1% compared to January's increase of 5.2%. Prices of imported commodities increased 6.9% during February from 6.4%, primarily due to a strong rand. The February producer price inflation met market expectations, with a Reuter's poll of economists expecting 5.5% inflation as well. Source: Statistics SA Release, P0142.1, March 30.

4th Quarter Growth Slows; Consumer Demand Still High

¶4. According to the South African Reserve Bank's (SARB) Quarterly Bulletin, South African 4th quarter 2005 growth slowed, primarily due to a substantial slowdown in inventory investment. Gross domestic expenditures increased 3.9% (q/q, seasonally adjusted) from the 3rd quarter 2005's growth of 7.4%. Household consumption remained strong, showing 6.8% growth during the last quarter 2005 compared to the third quarter growth of 6.1% growth. Government consumption expenditure growth more than doubled in the 4th quarter, showing 14.7% growth from 5.5% growth during the 3rd quarter. Table 1 gives the last two quarters' and 2005 annual growth rates of key demand-side indicators, adjusted for inflation.

| Table 1 | Q3 2005 | Q4 2005 | 2005 |
|-------------------------------|---------|---------|-------|
| Household consumption | 6.1% | 6.8% | 6.9% |
| Government consumption | 5.5% | 14.7% | 5.6% |
| Gross fixed capital formation | 7.0% | 7.5% | 8.0% |
| Gross domestic expenditures | 7.4% | 3.9% | 5.9% |
| Exports | 10.5% | -4.1% | 6.7% |
| Imports | 21.6% | -1.2% | 10.1% |
| GDP | 4.2% | 3.3% | 4.9% |

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¶5. An increase in real disposable income supported the strong increase in household consumption, but a substantial portion of increased household spending was financed by credit. During 4th quarter 2005, household debt as a percentage of disposable income rose to 65.5% from 63.5% in the previous quarter. Savings to disposable income of households reached 0.1%, the lowest rate ever reported. In a country with uneven distribution of wealth and a small minority of the population with access to credit, the debt may be concentrated in a relatively few number of households. Other factors supporting the strong growth in consumer spending are employment gains, wealth effects of increasing asset prices, high consumer confidence and low inflation and nominal interest rates. During the 4th quarter, real gross fixed capital investment showed strong growth, primarily due to a 15.5% increase in capital outlays by public corporations. Private sector capital formation increased 8%, while capital formation by government grew at slower rates.

¶6. The trade deficit on goods and services improved in the final quarter of 2005, narrowing to R10 billion from R20.7 billion in the 3rd quarter. However if net service income and current transfer payments were included, the balance on current account widened to R71.6 billion in 4th quarter 2005 compared to R68.4 billion during the 3rd quarter. As a percentage of GDP, the current account balance increased to 4.5% from 3rd quarter's 4.4% and for 2005, came in at 4.2% compared to 3.4% in 2004. The current account deficits have been financed by capital inflows. Source: Standard Bank QB Crux, Business Report and Investec SARB Quarterly Bulletin Update, March 23.

Skills Initiative Launched

¶7. Deputy President Mlambo-Ngcuka announced the beginning of a new skills initiative that would alleviate skills shortages in South Africa. The Joint Initiative on

Priority Skills Acquisition (JIPSA) will identify constraints in education and training and determine needed skills in the short to medium time frame. JIPSA will ensure that there are sufficient skills for the implementation of the R372 billion (\$60 billion, using 6.2 rands per dollar) three-year infrastructure development program that is a crucial component to successful implementation of the Accelerated and Shared Growth Initiative of South Africa (ASGISA). According to Mlambo-Ngcuka, South Africa wants to recruit skilled retirees and underemployed workers in South Africa first, and then extend the skill search overseas to foreigners and South Africans who had left the country. In addition, South Africa's Further Education and Training colleges will receive extra funding as part of an effort to increase artisan and technical skills. There are also program to ensure sufficient city, urban and regional planning and engineering skills; management and planning skills in education, health and municipalities; and teacher training in math, science, information and communication technology and language competence. JIPSA, which has an initial three-year lifespan, is made up of the joint task team, chaired by the Deputy President, and a technical working group, headed by Gwede Mantashe, General Secretary of the National Union of Mineworkers. Other members of the joint task team include the Ministers of Defense, Education, Home Affairs, Labor, Public Service and Administration, Public Enterprises, Science and Technology, Sport and Recreation, and Trade and Industry. Business representatives include Transnet's Maria Ramos, Eskom Chief Executive Thulani Gcabashe, Unilever SA's Gail Klintworth, Sasol's Pat Davies, Standard Bank's Jacko Maree, BHP Billiton SA's Executive Chairman Vincent Maphai, University of South Africa's Barney Pityana and AngloGold Ashanti's Bobby Godsell. Godsell wants South African companies to spend at least 5% of their labor costs on skills development. Source: Business Report, Business Day, March 28.

Non-Agricultural Employment Grows 1.3%

18. During the 4th quarter 2005, non-agricultural employment grew by 1.3% (q/q), with the service sectors showing the strongest growth, according to Statistics SA's

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Quarterly Employment Survey (QES). Mining and transport, storage and communication industries showed the largest 4th quarter job losses at -2.3% and -1.2%, respectively. The highest level of employment increases occurred in the wholesale and retail trade sector (50,000) followed by the financial services sector (30,000) and the construction sector (11,000). In the mining sector, 10,000 jobs were lost while the transport sector lost 4,000 jobs. Manufacturing, employing 17% of non-agricultural workers, reported a 0.8% increase or 10,000 jobs during the 4th quarter. For 2005, 158,000 non-agricultural jobs were created, contributing to a total of 7.3 million jobs. Gross earnings increased 6.9% in 2005 compared to the end of December in 2004. Table 2 shows annual growth in jobs and output for 2005. Source: Statistics SA, Release P0277.1 and Standard Bank, Labor QES, March 28.

Table 2

| | %Employment | Growth | Output | Growth |
|--------------------------|-------------|--------|--------|--------|
| Mining | 6% | -4.8% | | 3.1% |
| Manufacturing | 17% | 1.8% | | 4.1% |
| Construction | 6% | 20.6% | | 10.0% |
| Wholesale/Retail Trade | 20% | 3.1% | | 6.1% |
| Transport, Communication | 4% | 1.6% | | 5.6% |
| Finance/Real Estate | 21% | -0.7% | | 7.7% |
| Personal Services | 25% | 2.4% | | 2.5% |
| Total | | 2.2% | | 4.9% |

19. Comment. Statistics SA replaced the previous survey of non-agricultural firms, the Survey of Employment and

Earnings, with the QES in June 2005. The QES is a larger survey of 24,000 firms registered for taxes and includes firms in the small business sector. The Labor Force Survey, conducted every six months using 30,000 households, provides the official unemployment rate. End comment.

Social Security Agency Begins Operations

¶10. Social Development Minister Zola Skweyiya announced that the new Social Security Agency will start to pay social grants to beneficiaries in Gauteng, Western Cape and Northern Cape provinces. The Department created the new agency to distribute social grants after massive fraud was uncovered. The Social Security Agency will assume payment responsibility for the remaining provinces by March 2007. Skweyiya announced that the Department's Special Investigating Unit had had removed more than 130,000 fraudulent grant recipients from the grants register, and saved R4.5 billion (\$730 million). Source: Business Report, March 29.

SA Slips in ICT Rankings

¶11. The World Economic Forum (WEF) has ranked South Africa 37th out of 115 countries surveyed in its latest network readiness index (NRI), compared to 2004's ranking of 34. The NRI measures the country's ability to use information and communications technology (ICT) for development and increased competitiveness. The index examines a country's macroeconomic, regulatory and infrastructure environment; the readiness of individuals, businesses and governments to use and benefit from ICT; and its actual usage of the latest information and communications technologies. South Africa, which leads sub-Saharan Africa in network readiness, was ranked 35th in the environmental component and 42nd in individual usage. South Africa ranked highest in foreign technology licensing, which the WEF ranked 3rd, its financial market (12th), the effectiveness of its law-making bodies (13th), the efficiency of its legal framework (8th), and protection of property rights (19th). However, South Africa ranked lowest in the quality of math and science education (105th), the quality of the overall education system (81st) and the shortage of engineers and scientists (90th). In addition, shortage of telephone lines, poor quality of competition in the internet service provider industry and high monthly telephone subscription charges also led to lower overall rankings. South Africa has less than 5 million fixed telephone lines and also less than 5 million active computers. According to a report by World Wide Worx released in 2005, 3.6 million people are using the internet in South Africa out of an estimated

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population of 46 million. High telecommunications costs serve as a barrier for South Africa to increase the penetration of high speed internet access. Source: Business Day, March 29.

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